

## TEST YOURSELF ON BASIC FINANCIAL STATEMENTS

### True or False

For each of the following statements, circle the T or the F to indicate whether the statement is true or false.

- T   F   1.   The basic purpose of accounting is to provide financial information to economic decision-makers.
- T   F   2.   Financial statements are confidential documents made available only to the top management of a business enterprise.
- T   F   3.   The most useful financial statement would be a detailed list of every business transaction in which the business enterprise has been involved.
- T   F   4.   By using the transaction approach, one will be assured that all important events that happen in the firm are reflected in the financial statements of the company.
- T   F   5.   One characteristic of a corporation is that its owners are personally liable for any losses incurred by the business.
- T   F   6.   Assets are valued in the balance sheet at current liquidation values to show how much cash would be realized if the business went broke.
- T   F   7.   The cost principle of asset valuation is no longer used in the United States.

- T F 8. Losses from unprofitable operations cause the owners' equity in a business enterprise to decrease.
- T F 9. The purchase of a building for cash will cause total assets to increase.
- T F 10. The payment of a liability will not affect total assets, but will cause total liabilities to decrease.
- T F 11. A sole proprietorship is regarded as a separate legal entity from its owner.
- T F 12. The cash flow reported in the statement of cash flows will probably differ from the revenue and expenses reported in the income statement.
- T F 13. Meshing is the term used to describe the close "mechanical" relationship among the primary financial statements.
- T F 14. Corporations are required to show capital stock and retained earnings separately in the balance sheet.
- T F 15. A business that is able to pay its own debts is said to be *liquid*.
- T F 16. A business can become insolvent even though it is operating profitably.

### Completion Statements

Fill in the necessary word to complete the following statements:

- The three primary financial statements are the: (a) \_\_\_\_\_, (b) \_\_\_\_\_, and (c) \_\_\_\_\_.
- The three common forms of business organizations are (a) \_\_\_\_\_, (b) \_\_\_\_\_, and (c) \_\_\_\_\_.
- The accounting equation states that \_\_\_\_\_ = \_\_\_\_\_ + \_\_\_\_\_.
- Land advertised for sale at \$90,000 was purchased for \$80,000 cash by a development company. For property tax purposes, the property was assessed by the county at \$25,000. The development firm intended to sell the property in parcels for a total of \$150,000. The land would appear in the balance sheet of the development company among the \_\_\_\_\_ at a value of \$ \_\_\_\_\_.
- On December 15, Shadow Mountain Golf Course had a contractor install a \$90,000 sprinkler system. Since no payment to the contractor was required until the following month, the transaction was not recorded in December and was not reflected in any way in the December 31 balance sheet. Indicate for each of the following elements of the balance sheet whether the amounts were overstated, understated, or correct. Total assets \_\_\_\_\_, total liabilities \_\_\_\_\_, owners' equity \_\_\_\_\_.

6. The owners' equity in a business comes from two sources: (a) \_\_\_\_\_ by owner and (b) \_\_\_\_\_ operations.
7. A transaction that causes total liabilities to increase but that has no effect on owners' equity must cause total assets to \_\_\_\_\_.
8. The types of cash flows activities reported in the statement of cash flows are:  
(a) \_\_\_\_\_, (b) \_\_\_\_\_,  
and (c) \_\_\_\_\_.
9. \_\_\_\_\_ is the term used to describe the close "mechanical" relationship among the primary financial statements.
10. The concept of \_\_\_\_\_ requires providing with financial statements any financial facts necessary for proper interpretation of those financial statements.

### Multiple Choice

Choose the best answer for each of the following questions and enter the identifying letter in the space provided.

- \_\_\_ 1. Which of the following best describes the nature of an *asset*?
  - a. Something with a ready market value.
  - b. An economic resource which will provide some future benefits.
  - c. Tangible property (something with physical form) owned by a business.
  - d. The amount of the owner's investment in a business.
- \_\_\_ 2. The *owners' equity* in a business may best be described as:
  - a. An economic resource that is owned by a business and is expected to benefit future operations.
  - b. An obligation of the business entity.
  - c. Profits that have been retained in the business rather than being distributed to the Stockholders.
  - d. Assets minus liabilities.
- \_\_\_ 3. In this chapter, several accounting principles relating to the valuation of assets are discussed. Which of the following is not one of these principles?
  - a. The cost principle – assets generally are recorded at cost rather than at estimated market values.
  - b. Objectivity – accountants prefer to use values that can be objectively verified.
  - c. Going-concern assumption – accountants assume that a business acquires assets such as land, buildings and equipment for use and not for resale.
  - d. The safety principle – assets are recorded in the accounting records at the lower of cost or insured value.

- 4. Which of the following equations cannot be derived from the basic accounting equation ( $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$ )?
- a.  $\text{Assets} - \text{Liabilities} = \text{Owners' Equity}$ .
  - b.  $\text{Liabilities} = \text{Assets} - \text{Owners' Equity}$
  - c.  $\text{Owners' Equity} = \text{Liabilities} - \text{Assets}$
  - d.  $\text{Assets} - \text{Owners' Equity} = \text{Liabilities}$ .
- 5. Which of the following transactions causes *total assets to increase by \$10,000*?
- a. Purchasing an automobile for \$10,000 cash.
  - b. Purchasing \$10,000 of office furniture on account.
  - c. Collecting a \$10,000 account receivable
  - d. Paying a \$10,000 liability.
- 6. Magic Forest Land Development Company sold a parcel of land at a profit. This will cause:
- a. A decrease in assets and liabilities.
  - b. An increase in assets and owners' equity.
  - c. An increase in assets and liabilities.
  - d. A decrease in liabilities and owners' equity.
- 7. Lake Arrowhead Boat Shop bought a \$700 electric hoist to lift engines out of boats. The boat shop paid \$200 in cash for the hoist and signed a note to pay the balance in 60 days. This transaction will cause:
- a. The boat shop's assets to increase by \$700 and liabilities to increase by \$500.
  - b. Assets to increase by \$500 and owners' equity to decrease.
  - c. No change in total assets, but a \$500 increase in liabilities and a similar decrease in owners' equity.
  - d. No change in owners' equity, but a \$500 increase in both assets and liabilities.
- 8. Which of the following is an example of a cash inflow from operating activities?
- a. The purchase of a delivery truck.
  - b. The sale of an old delivery truck that is no longer being used.
  - c. Receiving a bank loan to purchase a new delivery truck.
  - d. The cash received from selling the products delivered to customers by the delivery truck.
- 9. Which of the following is an example of a cash inflow from investing activities?
- a. The purchase of a delivery truck.
  - b. The sale of an old delivery truck that is no longer being used.
  - c. Receiving a bank loan to purchase a new delivery truck.
  - d. The cash received from selling the products delivered to customers by the delivery truck.

- 10. Which of the following is an example of a cash inflow from financing activities?
- a. The purchase of a delivery truck.
  - b. The sale of an old delivery truck that is no longer being used.
  - c. Receiving a bank loan to purchase a new delivery truck.
  - d. The cash received from selling the products delivered to customers by the delivery truck.

### Exercises

1. Listed below are eight technical accounting terms emphasized in this chapter.

*Liquid*  
*Owners' equity*  
*Income statement*  
*Business entity*

*Objectivity principle*  
*Balance sheet*  
*Accounting equation*  
*Statement of cash flows*

Each of the following statements may (or may not) describe one of these technical terms. In the space provided below each statement, indicate the accounting term described, or answer "None" if the statement does not correctly describe any of the terms.

- a. A financial statement that shows detailed results of a company's profited-related activities for a particular period of time.  
\_\_\_\_\_
- b. An economic unit which enters into business transactions.  
\_\_\_\_\_
- c. Assets minus liabilities.  
\_\_\_\_\_
- d. Able to pay debts as they come due.  
\_\_\_\_\_
- e. An accounting assumption that a business will operate in the foreseeable future unless evidence suggests otherwise.  
\_\_\_\_\_
- f. A financial statement that reports the financial position of an enterprise.  
\_\_\_\_\_
- g. Assets minus the sum of liabilities and owners' equity.  
\_\_\_\_\_

2. In the space provided below, prepare a balance sheet for the Titan Company at December 31, 20\_\_, from the following alphabetical list of accounts

Accounts payable.....	\$38,000	Capital Stock .....	100,000
Accounts receivable.....	37,000	Retained Earnings.....	30,000
Automobiles .....	8,000	Land .....	35,000
Buildings .....	60,000	Office equipment .....	16,000
Cash.....	14,000	Property taxes payable	2,000

(Hint: The sum of the Capital Stock and Retained Earnings equals the owners' equity.)

**TITAN COMPANY**  
**Balance Sheet**  
**December 31, 20\_\_**

Assets		Liabilities & Owners' equity	
	\$		\$
	\$		\$

3. Use the following information to complete the balance sheet of the Unitrex Company on December 31, 20\_\_.
- The company was organized on January 1, 20\_\_, and has operated for a full year.
  - The land and building were purchased for a total price of \$350,000 on December 30, 20\_\_.
  - The seller was asking \$390,000 and the appraisal by the insurance company was \$360,000. Cash and Accounts Receivable together amount to three times as much as Accounts Payable.

The company's partial balance sheet is shown at the top of the following page.

Determine the missing figures in the Company's balance sheet shown below:

**UNITREX COMPANY**  
**Balance Sheet**  
**December 31, 20\_\_**

<b>Assets</b>		<b>Liabilities &amp; Owners' equity</b>	
Cash .....	\$42,000	Liabilities:	
Accounts receivable .....		Notes payable .....	\$
Land.....	90,000	Accounts payable .....	
Building.....		Total liabilities .....	\$112,000
Office equipment.....	<u>56,000</u>		
		Owners' equity:	
		Capital Stock .....	400,000
Total assets .....	\$ <u>      </u>	Retained Earnings .....	<u>          </u>
		Total Owners' Equity .....	<u>          </u>
		Total liabilities & owners' equity .....	<u>\$592,000</u>

4. The Billiard Den was organized by Robert Neal on July 1 of the current year. On the following page, indicate the effect of each of the following transactions on the various balance sheet items of the Billiard Den. Indicate the new balance for every item after the July 3 transaction and each subsequent transaction. The effects of the July 1 transaction are already filled in to provide you with an example.

- July 1** Robert Neal began the business by depositing \$20,000 cash in a bank account in the name of the business. The money was raised by selling shares of capital stock to himself and other family members.
- 3** Purchased an existing pool hall at a price of \$21,000 for the land and \$30,000 for the building. Billiard Den paid the former owner \$10,000 in cash and issued a short-term note payable for the balance of the purchase price.
- 10** Purchased 10 pool tables for \$1,000 each, paying \$6,000 cash and agreeing to pay the balance within 30 days.
- 14** Sold one pool table to a friend for \$1,000. The friend paid \$500 cash to the Billiard Den and promised to pay the balance within 30 days.
- 20** Paid \$2,000 of the amount owed on the pool tables.
- 24** Collected \$200 from the friend who has bought the pool table.
- 29** Purchased one used pool table from another pool hall, paying \$600 cash.
- 31** Cash revenue earned in July amounted to \$5,000. Cash expenses incurred for the month totaled \$3,500.

Assets				=	Liabilities		+	Owners' Equity	
	Cash	Accounts Receivable	Land	Building	Pool Tables	Notes Payable	Accounts Payable	Capital Stock	Retained Earnings
July 1	+20,000							+\$20,000	
3									
Balances									
10									
Balances									
14									
Balances									
20									
Balances									
24									
Balances									
29									
Balances									
31									
Balances									